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Letter Ruling 03-5: Composite Returns, QSUB Trust Beneficiaries

May 30, 2003

You request a letter ruling on behalf of ***** (Company) regarding the eligibility of certain of Company's shareholders to participate in the filing of a composite return for purposes of the Massachusetts personal income tax.

I. *Facts*

The following is your representation of the facts upon which we base our letter ruling. Company is a non-Massachusetts S corporation. Company has twelve shareholders. Three of the shareholders are residents of Massachusetts. Six of the shareholders are individuals who are non-residents of Massachusetts. The three remaining shareholders are Qualified Subchapter S Trusts (QSSTs) that are non-residents of Massachusetts.

Each QSST is a grantor-type trust under Internal Revenue Code § 678. Although each QSST will file a federal fiduciary income tax return, the income from Company will not be reported on the federal return. Instead, a statement will be attached to the federal return to indicate that all of the income reported on the federal Schedule K-1, Shareholder's Share of Income, Credits, Deductions, Etc., for the Company will be reported on the individual return of the QSST beneficiary. Each of the QSSTs has one individual income beneficiary, who is a non-resident of Massachusetts. All nonresident shareholders of Company meet the other requirements for inclusion in a Massachusetts composite tax return.

II. *Ruling Requested*

You request a ruling that permits Company to include the non-resident beneficiaries of the QSSTs in a composite income tax return filed by Company on behalf of its eligible Massachusetts non-resident shareholders.

III. *Discussion of Law*

For taxable years beginning on or after January 1, 1997, any S corporation with two or more qualified electing non-resident shareholders may file a composite tax return as an agent for the qualified electing non-resident shareholders. See Massachusetts regulation, 830 CMR 62.5A.1(12)(f)-(g), Non-Resident Income Tax. If a composite return is filed, no individual returns are required to be filed.

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In general, to be “qualified,” a non-resident shareholder must meet several requirements set forth in the Non-Resident Income Tax Regulation (the “Non-Resident Regulation”), including the requirement that “the shareholder must be an individual or the estate or trust of a deceased non-resident partner.” See 830 CMR 62.5A.1(12)(f)1.a. The other requirements are that the non-resident shareholder must: (1) be a non-resident for the entire year; (2) have no other Massachusetts source income other than income from the S corporation; [\[1\]](#) (3) sign the required Massachusetts statement for composite returns; and (4) waive the right to claim Massachusetts deductions, exemptions and credits. See 830 CMR 62.5A.1(12)(f)1.b-e. Shareholders included in a composite return must also have the same taxable year, which generally will be the calendar year. See 830 CMR 62.5A.1(12)(f)3.

The Department has ruled in the past that S corporation shareholders that were not individuals or estates or trusts of deceased non-resident shareholders were otherwise eligible to participate in the filing of a composite return by the S corporation. See LRs 98-19, 03-1. In those rulings, the shareholders at issue were Electing Small Business Trusts (ESBTs) which possessed many of the tax attributes similar to an individual who owns shares in an S corporation. See *also* LR 01-10. As presented here, each of the three QSSTs that are shareholders of the Company are grantor-type trusts under I.R.C. § 678. Under that section, a person other than the grantor is treated as the substantial owner of the trust. See *also* I.R.C. § 1361(d). Accordingly, the non-resident individual beneficiary of each QSST is treated as the owner of the QSST. As such, the individual beneficiary is responsible for including in his or her federal income his or her pro rata share of the S corporation income, as received by the QSST. See I.R.C. § 641(a). For Massachusetts purposes, a grantor trust acts as a conduit and income from the trust is taxed not to the trust, but to the grantor or other person treated as the owner of the trust. G.L. c. 62, § 10(e), DD 89-4; LR 88-10. For Massachusetts income tax reporting purposes, the three beneficiaries are subject to the same income reporting requirements as the non-resident individual shareholders who directly own Company stock. Any Massachusetts source income of these beneficiaries, as well as of the non-resident individual shareholders, is subject to tax under G.L. c. 62, § 5A.

IV. Conclusion

Based on the above, we rule that the non-resident beneficiaries of the QSSTs are eligible to participate in the filing of a composite income tax return by Company on behalf of its eligible Massachusetts non-resident shareholders if they otherwise meet and comply with the provisions of 830 CMR 62.5A.1(12).

Very truly yours,

/s/Alan LeBovidge

Alan LeBovidge
Commissioner of Revenue

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[\[1\]](#) This includes Massachusetts source income of the partner’s spouse, if any. See 830 CMR 62.5A.1(12)(f)1.c.